

VZCZCXRO2004  
PP RUEHBZ RUEH DU RUEHJO RUEHMR RUEHRN  
DE RUEHLS #0479/01 1211246  
ZNR UUUUU ZZH  
P 301246Z APR 08  
FM AMEMBASSY LUSAKA  
TO RUEHC/SECSTATE WASHDC PRIORITY 5757  
INFO RUCNSAD/SOUTHERN AF DEVELOPMENT COMMUNITY COLLECTIVE  
RUEHNR/AMEMBASSY NAIROBI 3733  
RUEHRO/AMEMBASSY ROME 0458  
RUEATRS/DEPT OF TREASURY WASHDC  
RUCPDOG/DEPT OF COMMERCE WASHDC  
RUEHRC/USDA FAS WASHDC  
RUEHLMC/MILLENNIUM CHALLENGE CORP 0069

UNCLAS SECTION 01 OF 04 LUSAKA 000479

SIPDIS

DEPARTMENT FOR EEB/TPP/ABT/ATP (JANET SPECK)

SENSITIVE

SIPDIS

E.O. 12958: N/A

TAGS: [EAGR](#) [EAID](#) [ECON](#) [ETRD](#) [PGOV](#) [PREL](#) [KMCA](#) [ZA](#)

SUBJECT: RESPONSE: IMPACT OF RISING FOOD/COMMODITY PRICES -  
ZAMBIA

REF: STATE 39410

LUSAKA 00000479 001.2 OF 004

¶1. (U) Summary. This cable responds to questions in reftel regarding the impact of rising food/agricultural commodity prices in Zambia. Although Zambia is experiencing food price inflation, at rates exceeding overall inflation, its prices are not directly tied to global market prices, and therefore somewhat shielded from international price volatility. Although the Government of Zambia has export restrictions in place on Zambia's staple commodity, maize, and in late 2007 had politically-motivated import restrictions on wheat, it has not introduced additional measures to mitigate against world price increases. Post has not submitted prior reporting on the impact of the recent price increases. End Summary.

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Impact on Demand  
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¶2. (U) Because in most years Zambia is not a net importer of food and agricultural commodities, Zambian food and agricultural commodity prices are not directly tied to, or affected by, global market prices. Domestic food and agricultural demand is also relatively independent of global market developments. Much of Zambia's production is consumed locally and most of what Zambia consumes is produced in the region. An estimated 50 percent of rural Zambians are net buyers of food, compared to 28 percent who are net sellers. Government of Zambia (GRZ) market interventions keep domestic prices low for maize, Zambia's staple food, which constitutes 56 percent of Zambia's total dietary energy supply. Rural poverty is linked more to low agricultural productivity, droughts, floods, and poor distribution, than it is to high international prices.

¶3. (U) Nevertheless, nominal basic food prices in Lusaka have increased by as much as 33 percent in the past twelve months. (Zambia's year-on-year annual inflation rate, as of March 2008, is approximately 9.8 percent.) According to retail price survey data provided by a local NGO/think-tank, the Jesuit Center for Theological Reflection, between October 2007 and March 2008, Lusaka prices for maize meal increased by 17 percent. During the same period, prices for beans increased by 66 percent, cooking oil by 69 percent, and bread by 36 percent.

¶4. (U) Maize price increases, which may be even higher in rural

areas, are customary in February and March during the peak lean season, prior to the April harvest. Nevertheless, the year-on-year maize meal nominal price increase (May 2007 to May 2008) is almost 19 percent, suggesting that the price increases are not entirely seasonal. The increases appear to be due primarily to higher transportation and production costs, as well as output levels in 2007/2008 that were significantly lower than those of 2006/2007, when Zambia enjoyed a bumper harvest.

15. (U) In the 2007/2008 harvest year, domestic production is expected to come very close to satisfying domestic consumption. In years of severe drought, such as 2002 and 2003, Zambia's agricultural trade balance was negative, due to large imports of maize and wheat. However, commercial wheat production will soon meet domestic demand, and Zambia could become a net exporter within two to three years. Rising prices have not affected consumption patterns or resulted in shifts to other commodities.

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Impact on Supply  
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16. (U) Given recent production, domestic supply has mostly satisfied local demand and global prices have not had a significant impact on supply. Rapid price increases, if combined with reductions in international food aid and low agricultural output, could adversely affect the poorest segments of the population. Despite Zambia's ample food production levels, there are pockets of food insecurity. Remote areas that are vulnerable to flooding experience severe food shortages almost annually. As many as 275,000 people will require food assistance in the first half of 2008, due to rainfall levels, flood-induced damages to infrastructure, and displacement of people. Zambia's poor internal distribution and transportation network, makes it difficult to properly distribute food from producers to consumers and to provide aid to affected areas.

LUSAKA 00000479 002.2 OF 004

17. (U) Zambia's Food Reserve Agency (FRA) makes large-scale maize purchases annually to maintain a five-month stock of maize, amounting to approximately 250,000 tons. However, in 2007, the government purchased over 400,000 tons, approximately 70 percent of marketable maize. One-third of government stocks are estimated to be spoiled, due to inadequate storage technology and controls, and inability to transport stocks to those who need or want it. According to some reports, the FRA loses about USD 110 on each ton of maize that it purchases. In 2008, the FRA has sold 200,000 tons of maize to neighboring countries as well as local vendors.

18. (U) To date there is no evidence that production has responded to price increases. Nor are there reports of increased domestic or foreign investment in food production. In the event of sustained, high global food and agricultural commodity prices, Zambian commercial farmers may seize export opportunities and increase production.

19. (U) Expanding Zambia's production capacity will require considerable public and private sector investment. Currently, less than 15 percent of Zambia's arable land is utilized for farming. Commercial farming is encumbered by lack of transportation infrastructure, market access, technology, irrigation, storage facilities, and financing. Traditional leaders' control of most rural lands also lends difficulties to commercial development. An incomplete agricultural supply chain, caused by a deficit of well-run cooperatives, stunts sectoral growth. Lacking resources or capacity to market their products, small-scale Zambian farmers rely upon intermediary brokers who offer well-below market prices.

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Domestic Politics  
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110. (SBU) Food and agricultural commodity price increases have not caused public protests or other forms of civil unrest as yet. Nevertheless, maize price increases in 1986 and 1991 resulted in violent riots, numerous deaths, and an eventual change in

government. There are no indications at this moment that this might repeat itself, perhaps due to the availability of alternative food products, and Zambians' familiarity with double-digit inflation. However, the situation could change rapidly, for example, if the harvest falls far short of domestic needs. Food supply and price levels therefore bear close watching in Zambia.

¶11. (SBU) Given the small size of Zambia's biofuels projects, the public is mostly indifferent to the issue of biofuels. Although the National Energy Policy includes biofuels promotion, the GRZ has done very little to this end. Despite considerable commercial interest in cultivating the oil-rich jatropha plant, President Mwanawasa has warned that jatropha production will be banned if specialists conclude that jatropha farming is bad for the soil. Zambians are also indifferent to biotechnology and Genetically Modified Organisms (GMOs), despite GRZ opposition. In recent years, opposition parties and labor unions have criticized the infusion of Chinese investment, alleging that Chinese companies engage in corrupt practices and do not abide by environmental and labor laws. Chinese investment in the retail (including food) sector has intensified this resentment.

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Domestic Economy  
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¶12. (SBU) Fuel, food and agricultural commodity price increases are sure to make it difficult for the GRZ to maintain its target of single-digit inflation. Price increases are unlikely to have an impact on Zambia's fiscal situation or external debt outlook. External debt sustainability, which improved substantially thanks to HIPC debt relief in 2005, is unlikely to be affected, unless the GRZ seeks large loans to alleviate hunger, develop infrastructure, and support agricultural growth. The GRZ has so far been cautious about taking on new external debts in the post-HIPC timeframe.

¶13. (U) Since 2003, Zambia has had a positive agricultural trade balance. If Zambia develops its agricultural sector to increase export earnings, it is likely to have a favorable impact on the country's balance of payments and trade balance. Until then, the effect of rising prices on the balance of payments and trade balance will vary from year to year, but generally be negligible, due to mining sector growth and agriculture's comparably modest share of

LUSAKA 00000479 003.2 OF 004

export earnings (less than three percent in 2006).

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Environmental Impact  
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¶14. (U) Recent price increases have had no reported environmental impact. Sustained high fuel prices may contribute to deforestation and soil erosion, as low-income, rural households increase their use of timber and charcoal for heating and cooking.

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Government Policies  
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¶15. (U) The GRZ utilizes import and export restrictions, which dampen prices, to ensure adequate domestic supplies. It also intervenes in the market by making large, price-distorting stock purchases of maize for the FRA. If prices rise further, however, some analysts anticipate price controls on maize and other key commodities. GRZ representatives have been slow to address the price increases, and there is little public debate on the topic, nor indication that the GRZ will interfere in the market. The GRZ has not proposed changes to trade, environment, biotechnology, SPS, or other policies.

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Impact on Mission Programs  
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¶16. (SBU) The efficacy of many USG development programs in Zambia

are likely to be limited by rapid increases in prices, particularly the President's Emergency Plan for AIDS Relief (PEPFAR) and the President's Malaria Initiative. Additionally, education programs will reach fewer audiences if increased rural poverty and hunger limit levels of school attendance. Food assistance that is allocated in USD terms, rather than volume (weight), will be diluted by increased prices (and a depreciated Dollar) and therefore reach fewer households. For the current fiscal year, Food for Peace stocks arrived before the price increases. No impact on tonnage levels is expected until fiscal year 2009. The USG Economic Growth programs could realize improved income and trade results if Zambia adapts its trade and agricultural policies to mount a supply response to the global increases in commodity prices.

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Policy Changes for Zambia  
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¶17. (SBU) Post will continue to urge the GRZ to refrain from all forms of market intervention. However, given the GRZ's propensity for--and history of--intervening, the GRZ ought to consider consumer subsidies in lieu of controls that discourage productivity. These could include time-limited subsidies, such a reduction on value added tax (VAT) for more food products (staple foods are already VAT exempt), or an increase in the exemption threshold for the Pay As You Earn (PAYE) taxation scheme.

¶18. (SBU) The GRZ should consider the full range of food security measures, including not just a sufficient food reserve, but appropriate agricultural and social policies. Policies could include lifting the prohibition on Genetically Modified Organisms, although this is a highly sensitive political issue. Another policy option includes reducing Food Reserve Agency stock purchases, which interfere with market prices, usually spoil, and rarely are delivered to impoverished regions of the country. Perhaps more importantly, the GRZ should consider phasing out its export restrictions, in order to allow cross-border trading and the free movement of goods.

¶19. (SBU) The GRZ's fertilizer support program consumes the lion's share of the GRZ's agriculture budget, yet provides benefits to only a small percentage of the agricultural sector (and usually to farmers who need it least). The program impedes the development of a commercial fertilizer industry, perpetuates a culture of entitlement, and causes delays in planting. Fertilizer support funds ought to be diverted to infrastructure development, such as road and railway transport, storage facilities, training, irrigation, and the overall improvement of competitiveness and production capacity.

LUSAKA 00000479 004.2 OF 004

¶20. (SBU) Market-driven agricultural growth and thoughtful, targeted social safety net policies may be Zambia's only insurance against rising prices (and possible social unrest), and a solution to endemic poverty and hunger. Over three-fourths of Zambia's work force is employed in the agricultural sector (mostly small-scale), and yet agriculture accounts for less than twenty percent of the Gross Domestic Product. Increased productivity would generate wealth in rural areas with side-benefits in other sectors, including health and education.

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Policy Recommendations for the USG  
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¶21. (SBU) In order to address rising food and agricultural commodity prices, the USG should continue--and perhaps expand--its assistance to agricultural development in regions, like Zambia, where opportunities exist for sectoral growth. Besides helping to eradicate poverty, increased productivity could contribute to greater global food security. At the same time, the USG should continue to monitor food price and supply levels in Zambia closely, and offer technical assistance to help the GRZ design and implement proactive policies that will minimize the risk of social unrest driven by food shortages.

¶22. (SBU) To accomplish this, U.S. development assistance should continue to focus on sustainable economic development, particularly ways to improve farming productivity. U.S. dialogue on food security with other donors and host countries should also continue to stress this approach. Absent this focus, other countries' development activities run the risk of interfering with emerging small-scale commercial farming, perpetuating market inefficiencies, and fostering a culture of entitlement.

¶23. (SBU) Post will continue to advocate for GRZ agricultural policy reform and will encourage the banking sector to develop risk-mitigating vehicles for agricultural sector lending and related infrastructure investments. USAID programs in Zambia will also continue to address inefficiencies in the agricultural value chain, by improving market access and increasing the availability of veterinary services, technology, advice, and financing.

¶24. (SBU) In the event that Zambia qualifies for a Millennium Challenge Account compact, the USG could help the GRZ develop a proposal for agricultural infrastructure development, including road, rail, and irrigation, in order to unlock the sector's export potential. This would go a long way in support of the GRZ's poverty reduction strategy and the United Nations Millennium Development Goals.

MARTINEZ